SUPREME COURT U. S.

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Supreme Court of the United States

OCTOBER TERM, 1967

No. 1205

BEN D. SPIVAK and DAVID S. SHAPIRO,

Petitioners,

against

UNITED STATES OF AMERICA.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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212—MU. 6-0750

INDEX

	PAGE
Opinion Below	1
Jurisdiction	2
Questions Presented for Review	2
Constitutional Provisions, Statutes and Regulations Involved	3
Statement of the Case	4
Argument	6
Reasons for Granting the Writ	6
I	7
II	9
III	12
IV	13
Appendix	15
Opinion of the Court of Appeals	15
Relevant Statutes	21

TABLE OF CITATIONS

CASES

Bloom v. *United States*, 272 F. 2d 215 (C. A. 9), cert. denied, 363 U. S. 803	13
In Re Chicago Rapid Transit Co., 196 F. 2d 484 (C. A. 7)	8
Connecticut Ry. and Lighting Co. v. *New York, N. H. & H. R. Co.*, 190 F. 2d 305 (C. A. 2)	8
Dibble v. *Richardson*, 171 N. Y. 131; 63 N. E. 829	13
Gholson v. *Savin*, 137 Ohio St. 551, 31 N. E. 2d 858	11

PAGE

Grow v. *Garlock*, 97 N. Y. 81 13

Horwitz v. *United States*, 339 F. 2d 877 (C. A. 2) .. 13

Kebro Enterprises v. *Four Seasons Caterers*, 25 A. D. 2d 307, 310; 269 N.Y.S. 2d 291 11

Kelly v. *Lethert*, 362 F. 2d 629 (C. A. 8) 10

Kramer v. *Morgan*, 85 F. 2d 96 (C. A. 2) 11

Pearlman v. *Reliance Insurance Co.*, 371 U. S. 132 .. 12

Phillips-Jones Corp. v. *Parmley*, 302 U. S. 233 13

In Re Prudence Co., Inc., 98 F. 2d 559 (C. A. 2), cert. denied, *sub nom. Stein* v. *McGrath*, 306 U. S. 636 ..... 8, 9

Reconstruction Finance Corp. v. *Central Republic Trust Co.*, 128 F. 2d 242 (C. A. 7) 10

St. Paul Fire & Marine Insurance Co. v. *United States*, 370 F. 2d 870 (C. A. 5) 12

Spies v. *National City Bank*, 174 N. Y. 222; 66 N. E. 736 11

Technical & Chem. Works v. *Two Guys From Massapequa*, 327 F. 2d 737 (C. A. 2) 8

United States v. *Coast Wineries*, 131 F. 2d 643 (C. A. 9) 7, 8

United States v. *Ross*, 176 F. Supp. 932 (D. C., Nebr.) 11

United States v. *Walley*, 259 F. 2d 579 (C. A. 9) 9

In Re Van Camp Products Co., 95 F. 2d 206 (C. A. 7), cert. denied, *sub nom., Shubrick* v. *Van Camp Products Co.*, 305 U. S. 605 8

In Re Yale Express System, Inc., 362 F. 2d 111, 116 (C. A. 2) 13

PAGE

STATUTES

Bankruptcy Act, Title 11, U.S.C.:
§ 50 ..... 3, 8
§ 104(a) 8
Internal Revenue Code of 1954, Title 26, U.S.C.:
§ 6672 ..... 1, 2, 3, 6, 14

MISCELLANEOUS

72 C.J.S., *Principal and Surety*, § 153 11
2 *Remington on Bankruptcy*, § 1157 9
Stearns on Suretyship (4th Ed.), § 102, p. 147 11
2 *Williston, Contracts* [1936 rev.], § 339, p. 1003 11
4 *Williston, Contracts* [1936 rev.], § 1230 11
4 *Williston, Contracts* [1936 rev.], § 1265 13
50 *Yale L. Journal* [1941], p. 1485 11

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No. .....

BEN D. SPIVAK and DAVID S. SHAPIRO,

Petitioners,

against

UNITED STATES OF AMERICA.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners respectfully pray that this Court issue its Writ of Certiorari to review the judgment of the United States Court of Appeals for the Second Circuit affirming the judgment of the United States District Court for the Southern District of New York, which dismissed the petitioners' complaint for refunds of partial payments made on 100% penalty assessments against petitioners pursuant to §§ 6672, 6671(b), Title 26, U.S.C. and which granted the Government judgment on its counterclaim for the balance of the penalty assessments in the amount of $27,192.27 with interest and costs.

Opinion Below

The opinion of the Court of Appeals, per Smith, C.J., has been officially reported at 370 F. 2d 612 and is printed *infra* at page 15.

The District Court's opinion is officially reported at 254 F. Supp. 517 and printed in the Appendix to Appellants' Brief in the Court of Appeals, pages 69a to 91a.*

Jurisdiction

The judgment of the Court of Appeals was dated and entered on January 4, 1967.

Jurisdiction to review the judgment of the Court of Appeals by the Writ prayed for is conferred on this Court by § 1254, Title 28, U.S.C. and is invoked pursuant thereto.

Jurisdiction over the petitioners' causes of action for refunds was conferred on the District Court by § 1346(a)(1), Title 28, U.S.C. The District Court exercised jurisdiction over the Government's counterclaim under §§ 1340, 1345, 1346, Title 28, U.S.C., and §§ 7401, 7402, 7403(a), Title 26, U.S.C. (85a).

Questions Presented For Review

1. Whether the Bankruptcy Court's approval of the Compromise Agreement (93a-98a) settling the controversy between the Government and the bankrupt's Trustee as to the validity and amount of the Government's claim for the withheld taxes in question constituted a final adjudication conclusively precluding the Government from attempting to collect the balance of its compromised claim from petitioners under the guise of 100% penalty assessments under § 6672, Title 26, U.S.C.

2. Whether the Government by releasing the bankrupt corporation from all further liability for Federal taxes, at a time when the bankrupt's estate was sufficient to pay

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* References thus are to the pages of the Appendix to Appellants' Brief in the Court of Appeals filed with this petition.

all allegedly unpaid taxes in cash, and by consenting to the compromise of its tax claims in full was precluded as matter of law from attempting to collect the balance of the compromised tax claim from petitioners by means of a "reservation of rights" in the settlement agreement (93a, 98a) to which petitioners were not parties.

3. Whether the procedure here followed by the Government in attempting to collect the allegedly unpaid withholding taxes could alter or impair the rights of petitioners as indemnitors or sureties under the general law to have recoupment from the bankrupt corporation, or is the Government bound to refrain from any act or omission which would prejudice or impair such rights.

4. Whether, since the assets of the bankrupt corporation were sufficient to satisfy the Government's tax claim in full in cash without regard to the Trustee's objections respecting the validity and amount of such taxes and the Government affirmatively elected to participate in the bankrupt's estate and conclusively settled its tax claim in full, the petitioners can be held to have "willfully failed to pay over" the taxes in question within the fair meaning and intendment of § 6672, Title 26, U.S.C.

Constitutional Provisions, Statutes and Provisions Involved

The pertinent constitutional provisions, statutes and regulations are lengthy and are set forth as an appendix to this petition, *infra,* page 21 *et seq.,* and their citations follow:

Internal Revenue Code of 1954, §§ 6672, 6671(b), Title 26, U.S.C.;
Bankruptcy Act, §§ 50, 104(a), Title 11, U.S.C.

Statement of the Case

In or about June, 1954 the petitioners became officers of Lincoln Industries, Inc., a Virginia furniture manufacturing corporation (10a, 27a) and resigned as such officers in May, 1956 (12a, 28a).

Previously a bona fide dispute arose between Lincoln Industries and the Internal Revenue Service regarding the application of payments made on that corporation's defense contracts by the Reconstruction Finance Corporation to Internal Revenue (Finding of Fact No. 8; 71a). Lincoln Industries claimed that these payments should have been applied to its tax liabilities and not, as was being done, to the tax debts of its parent corporation, Virginia-Lincoln Corporation, such application being contrary to the directions of Lincoln Industries and over its objections (Finding of Fact No. 8; 71a).

The District Court specifically found as a fact that had the disputed payments amounting to $101,558.70, been credited to Lincoln Industries, these would have completely satisfied and discharged the tax liabilities in question (Finding of Fact No. 8; 71a). Petitioners learned of this dispute shortly after they took office and retained counsel in an effort to have the disputed payments reapplied properly (Finding of Fact No. 9; 72a).

After petitioners took office, Lincoln Industries became delinquent in making payments of its withholding and F.I.C.A. tax liabilities for several quarters in 1954 and again in 1956, but payments were made for several other quarters during the period in question (100a). During this period bills for raw materials and labor were paid and taxes were paid when cash was accumulated (Finding of Fact No. 10; 72a).

Lincoln Industries was adjudicated a bankrupt on July 16, 1956 (Finding of Fact No. 4; 70a). On August 20,

1956 the Government find a Proof of Claim against the bankrupt's estate for unpaid withholding, F.I.C.A. and F.U.T.A. taxes, penalties and interest, which, as amended, totaled $107,135.02 (Finding of Fact No. 5; 70a; 93a).

The Trustee of the bankrupt disputed the entire claim for taxes and asserted that no taxes at all were due. This position was based on the misapplications of payments by Internal Revenue (6a; 44a). The Trustee also disputed a similar misapplication of a payment of $7,028.74 made in 1956 after the adjudication of bankruptcy (6a; 44a; 45a).

In February, 1960 the Trustee and the Government agreed to compromise the tax controversy for the sum of $50,000 to be paid to the Government, less the payment of $7,028.74 misapplied after bankruptcy, to be retained by the Government with a credit therefor to the Trustee (47a). The Trustee agreed to pay the net amount of $42,971.26 in cash to the Government to be applied against specified quarters (93a).

The Trustee petitioned the Bankruptcy Court for approval of the compromise and at the hearing held on the petition the Trustee's counsel argued for its approval by the Referee (93a; 45a-47a). After the hearing the Referee made an order approving the compromise (93a-99a).

The District Court here made a specific finding of fact that at the time the settlement was made and approved, the Trustee had sufficient cash on hand in the estate to pay the entire tax claim of the Government (Finding of Fact No. 6; 71a).

The Order approving the compromise provided that it was in settlement of "all tax claims of the United States against Lincoln Industries, Inc., the bankrupt, in the stated amount of $107,135.02, including penalties and interest thereon" (93a), and that the Bankruptcy Court found that "the settlement is a fair, reasonable and just settlement

of the differences between the Trustee and the United States regarding all tax claims of the United States against the bankrupt'' (97a).

The settlement agreement provided that the Trustee waived any claims for refunds of federal taxes and that the Government released the bankrupt and its Trustee from all further claims for taxes (94a).

The Compromise Agreement provided that the settlement was to be without prejudice to the Government in the ''assessment and collection of any outstanding assessments for penalties against former officers'' of the bankrupt ''on account of said Witholding and F.I.C.A. taxes'' (94a).

After paying administration expenses, wage claims, secured claims and all tax and priority claims, the Trustee paid dividends to the general creditors of the bankrupt amounting to about $140,000 (9a).

On August 8, 1956 the Government had made assessments under § 6672, Title 26, U.S.C. against petitioners of penalties for failure to pay the witholding and F.I.C.A. taxes of Lincoln Industries for four quarters. The Government applied the settlement payment in abatement of certain quarters then assessed as penalties against petitioners, but left unabated the quarters here at issue (50a, 51a; 63a; 64a). This action for refund of partial payments was then commenced.

Argument

The reasons relied on by petitioners for the allowance of the Writ are these:

1. The decision below is in conflict with the decisions of other Courts of Appeal on the same matter;

2. The Court below has rendered a decision to conflict with applicable decisions of this Court;

3. The Court below has decided important questions of Federal law, which have not been, but should be settled by this Court;

4. The Court below has sanctioned such an unusual departure from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

I

The Court of Appeals has here held that the compromise of the Government's tax claim in the bankruptcy did not constitute an adjudication conclusively binding on the Government with regard to the amount of taxes owed by the bankrupt. It has held that the amount paid in settlement was "only a partial payment of the corporate obligation".

This holding not only is contrary to settled principles of law and does not give effect to the manifest intent of the parties in entering into the compromise, but also is in direct conflict with the holding of the Court of Appeals for the Ninth Circuit in *United States* v. *Coast Wineries*, 131 F. 2d 643 (C.A. 9). In the *Coast Wineries* case, *supra*, the Government filed a Proof of Claim in bankruptcy for certain allegedly unpaid taxes, certain items of which claim were objected to by the Trustee. The Trustee and the Government agreed to compromise the controversy, the Government to be paid for some taxes and the balance of the claim to be abated. The compromise was approved by the Court after hearing and the settlement agreement was fully executed. The Government some time later filed another Proof of Claim for a portion of the taxes abated under the compromise, but the Bankruptcy Court disallowed the latter claim upon the ground that the approval of the compromise conclusively disposed of the tax liability of the bankrupt.

After the disapproval of its claim for the reason stated, the Government attempted to sue the bankrupt's surety for the unpaid balance of the claim. The Court of Appeals in *Coast Wineries, supra,* squarely held that the disposition of the tax claim in the Bankruptcy Court, by compromise and settlement as here, conclusively barred the Government from attempting to recover the balance of the compromise claim from the surety. And the Government's argument that the liability of the surety was separate and distinct from the bankrupt's liability on the compromised tax claim was correctly dismissed by the Court which held that the compromise extinguished any such liability. *Coast Wineries, supra,* p. 649.

It is impossible to distinguish, on principle, the case at bar from the *Coast Wineries* case. The conflict in the holdings should be reviewed by this Court.

To reach its decision the Court below obviously had to adopt the Government's argument that the compromise did not reach or settle the merits of the controversy. That theory was rejected by the Court of Appeals for the Seventh Circuit in the case of *In re Van Camp Products Co.,* 95 F. 2d 206 (cert. denied *sub nom., Shubrick* v. *Van Camp Co.,* 305 U. S. 605) which held that a Bankruptcy Court's approval of a compromise is presumptively on the merits which cannot be relitigated in any collateral proceeding by either party to the compromise.* The same holding was made in *In re Chicago Rapid Transit Co.,* 196 F. 2d 484 (C. A. 7).

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* Indeed, the Court of Appeals here ignored its own holdings on the point which are directly in conflict with its decision here. *In re Prudence Co., Inc.,* 98 F. 2d 559 (C. A. 2) (cert. denied *sub nom. Stein* v. *McGrath,* 306 U. S. 636); *Connecticut Ry. and Lighting Co.* v. *New York N. H. & H. R. Co.,* 190 F. 2d 305 (C. A. 2); *Technical & Chem. Works* v. *Two Guys from Massapequa,* 327 F. 2d 737 (C. A. 2). All of the above cited authorities hold that a Bankruptcy Court is under a mandatory duty imposed by Congress to adjust the merits of the tax controversy before approving a compromise thereof. §§ 50, 104(a), Title 11, U.S.C.

II

The unilateral reservation of rights in the settlement agreement (94a) could not preserve any right to the Government to proceed independently against petitioners once that agreement had been fully executed by the parties. The Court of Appeals below held that the purported reservation of rights must be effective because the petitioners had notice of the hearing for approval and did not object to the compromise.

The Bankruptcy Court had no jurisdiction to adjudicate the Government's claim or rights against petitioners and no determination by that Court could personally bind the petitioners on the matters here in issue. *United States* v. *Walley*, 259 F. 2d 579 (C. A. 9). Assuming, *arguendo*, that petitioners were creditors of the bankrupt estate entitled to object to the proposed compromise, such objections as they might have made would have been merely advisory and not binding on the Bankruptcy Court which had sole authority and responsibility for approval of the settlement. 2 *Remington on Bankruptcy*, § 1157.

The agreement required, and was made subject to, the approval of the Referee and not of the petitioners (95a). The only parties who consented to it were the Government and the Trustee (98a). Since petitioners were not parties to the compromise and since the Bankruptcy Court had no jurisdiction to bind them to it, their failing to object thereto cannot be deemed to be acquiescence to the purported reservation.

To object successfully to the compromise, petitioners would have had to establish that as a *matter of law* either the Government or the Trustee was entitled to judgment on the disputed tax claim. *In re Prudence Co.*, 98 F. 2d 559 (C. A. 2), cert. denied, *sub nom., Stein* v. *McGrath*, 306 U. S. 636. Of course, judgment either way would have resulted in the complete payment and discharge of the

corporation's tax obligations. It is inconsistent and anomalous to hold that the compromise and settlement did not achieve the same result.

It is beyond dispute that the subject matter of the Government's claims against the bankrupt and the petitioners is absolutely identical, viz., the withheld taxes. In such circumstances the binding compromise made by the Government for less than the full amount of its claim in bankruptcy and its absolute release of the bankrupt from all further liability precludes the Government from claiming as against petitioners, that the tax indebtedness of Lincoln Industries was greater than the compromised and settled amount, regardless of the purported reservation clause. *Reconstruction Finance Corp.* v. *Central Republic Trust Co.*, 128 F. 2d 242 (C. A. 7).

The decision of the Court below is in conflict with a decision of the Eighth Circuit on this same issue. In *Kelly* v. *Lethert,* 362 F. 2d 629 (C. A. 8), it was held that § 6672, Title 26, U.S.C., imposed on corporate officers no greater liability than that of *legal suretyship* to protect the Government with regard to withheld taxes uncollectible from the corporation. *Kelly* v. *Lethert, supra,* at page 635. The Court below failed to give effect to this principle and it is submitted that its decision is in conflict therewith.

The Court below attempted to distinguish the cited case by citing it for the proposition, already firmly imbedded in the law, that a creditor may elect to proceed directly against a surety. At bar the Government proceeded first against the bankrupt thereby affirmatively electing to hold petitioners liable *as such sureties* for any uncollectible withheld taxes. *Kelly* v. *Lethert, supra.* The full amount of the tax indebtedness was collectible in the bankruptcy proceeding but was compromised by the Government and the bankrupt released.

It is firmly established that where the creditor, here the Government, compromises the indebtedness with a prin-

cipal obligor and releases the debt as to him, the other obligor is released as a matter of law regardless of any purported reservation of rights. This principle is brilliantly set forth in the opinion in *Gholson* v. *Savin*, 137 Ohio St. 551, 31 N. E. 2d 858, and that holding should be applied to the case at bar since it represents the modern and scholarly view of the law.

The reservation was ineffectual as a matter of law, since the mutual discharges contained in the compromise extinguished all possibility for petitioners to obtain reimbursement from the bankrupt corporation, which the Government elected to treat as principal. *Gholson* v. *Savin*, *supra*. No such reservation could be effectual unless petitioners could at once proceed against the bankrupt for reimbursement. *Kramer* v. *Morgan*, 85 F. 2d 96 (C. A. 2); 2 *Williston, Contracts* [1936 rev.], § 339. Since the compromise completely foreclosed any further litigation on the tax claim and constituted full satisfaction of the tax claims, the purported reservation must fall and be given no effect. 4 *Williston, Contracts* [1936 rev.], § 1230; *Stearns on Suretyship* (4th Ed.), § 102, p. 147; 50 *Yale L. Journal* [1941], p. 1485; 72 C.J.S., *Principal* and *Surety*, § 153.

The reservation is repugnant to the act of compromise and mutual discharge approved by the Bankruptcy Court and the surrender by the Government of the subject matter of the tax claim. Such unilateral reservations are abhorrent to the law and have never been enforced. *Spies* v. *National City Bank*, 174 N. Y. 222, 66 N. E. 736; *Kebro Enterprises* v. *Four Seasons Caterers*, 25 A. D. 2d 307, at page 310 (269 N.Y.S. 2d 291), and the authorities there cited.

Indeed, in the case of *United States* v. *Ross*, 176 F. Supp. 932 (D. C., Nebr.), it was held that the release of the Government's lien against partnership property extinguished the retiring partner's rights to subrogation and rendered ineffectual a reservation contained in the release of the

continuing partner. The taxes there in question were also withheld Federal taxes.

No sanction is found in either the Bankruptcy Act or the Internal Revenue Code for the purported reservation, so it is not surprising that the Court below cited no authority therefor.

The question presented by petitioners raises important issues of law which have not been, but should be, passed upon by this Court. It is respectfully submitted that this Court should adopt the reasoning of the authorities cited herein by petitioners, since they represent the modern and just view on these issues.

III

The Court of Appeals held that the Government was not bound to respect the rights of petitioners to reimbursement from their principal, and that the Government could proceed in derogation of such rights.

This holding is squarely in conflict with the holding of the Fifth Circuit Court of Appeals in the case of *St. Paul Fire & Marine Insurance Co.* v. *United States,* 370 F. 2d 870 (C. A. 5). That case holds that the Government in choosing a procedure to collect a tax cannot alter or impair rights of subrogation and reimbursement founded on general principles of law and equity. The Court below conceded that the Government had extinguished and prejudiced all petitioners' general law rights to seek reimbursement as either subrogees of the Government's claim or as subrogees of the Trustee's refund claim but held that the Government had a right so to prejudice and extinguish these rights.

Subrogation is a creature of equity, founded on principles of general law and not on contract or statute, and designed to further the ends of substantial justice. *Pearlman* v. *Reliance Insurance Co.,* 371 U. S. 132. The right thus accorded to seek reimbursement from a co-obligor, who in equity ought to bear the debt, prevents a creditor

from "throwing the ultimate payment of the debt in one way or another as suits his caprice". 4 *Williston Contracts*, § 1265, quoted with approval in *In re Yale Express System Inc.*, 362 F. 2d 111, at page 116 (C. A. 2).

The law has always charged a creditor with the duty of observing and respecting such rights to reimbursement, no matter what the form of debt or obligation might be, or whether or not the creditor assented to such rights. *Dibble* v. *Richardson*, 171 N. Y. 131, 63 N. E. 829; *Grow* v. *Garlock*, 97 N. Y. 81. Where, as here, such rights are prejudiced, the sureties are released by operation of law regardless of any reservations.

This Court has recognized common law rights accorded to transferees to seek contribution from other transferees and has held that such common law rights must be observed and respected. *Phillips-Jones Corp.* v. *Parmley*, 302 U. S. 233. It is inconsistent to hold, as the Court below has held, that petitioners' common law rights to subrogation and reimbursement may be prejudiced by the Government without any cause for petitioners to complain.

This Court has never reviewed the issues here presented and such review should be had, to settle substantial questions of law relating to the procedures mandated by Congress for collecting revenues from bankruptcy estates and relating to the rights of corporate officers to seek indemnification from the corporation's bankruptcy estate which contains sufficient funds to pay all taxes.

IV

The test of "willfulness" adopted by the Court below should be reviewed by this Court. That holding was based on the cases of *Bloom* v. *United States*, 272 F. 2d 215 (C. A. 9), cert. denied, 363 U. S. 803, and *Horwitz* v. *United States*, 339 F. 2d 877 (C. A. 2). Both of those cases involved "no-asset" bankruptcies and they are thus readily distinguishable from the case at bar. The petitioners did not frustrate the Government from collecting all the taxes

from the bankrupt's estate which was sufficient to pay taxes in full. The only penalty for mere failure to make timely payment is the addition of interest to the tax and that, too, was compromised in bankruptcy.

There is no time limitation imposed by § 6672, Title 26, U.S.C. with regard to a willful failure to pay over the taxes. Certainly when payment is made the duty to cause payment to be made is discharged and with it any sanction for prior delay in causing payment to be made. Thus, the petitioners cannot be held to have failed willfully to cause payment to be made of taxes which the Government conclusively admitted were never due and owing from the corporation when the bankrupt could have paid the taxes in full. The Government entered into such compromise because its case was admittedly imperiled by the Trustee's objections and defenses, and the Trustee would have been entitled to a refund had he prevailed.

In these circumstances, the Government may not resort to the provisions of § 6672, Title 26, U.S.C. to enlarge upon the basic obligation of the corporation for the taxes. The test adopted by the Court below permits the Government to do precisely that and its judgment should be reviewed by this Court to settle the questions of law presented thereby which have not been passed upon by this Court and which relate to the proper administration of the Internal Revenue laws.

WHEREFORE, it is respectfully prayed that a Writ of Certiorari issue to the Court of Appeals for the Second Circuit to review its judgment.

Respectfully submitted,

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212—MU. 6-0750

Dated: March 29, 1967

APPENDIX TO PETITION

Opinion of Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 206—September Term, 1966.

(Argued November 29, 1966 Decided January 4, 1967.)

Docket No. 30633

BEN D. SPIVAK and DAVID S. SHAPIRO,

Plaintiffs-Appellants,

v.

UNITED STATES OF AMERICA,

Defendant-Appellee.

Before:

LUMBARD, *Chief Judge,*
FRIENDLY and SMITH, *Circuit Judges.*

Appeal from judgment in the United States District Court for the Southern District of New York, Richard H. Levet, *Judge,* dismissing complaint in tax refund action and for the United States on counterclaim for penalties against responsible corporate officers for failure of corporation to pay over income withholding and social security taxes.

Affirmed.

MYRON L. SHAPIRO, New York, N. Y. (Donald J. Swords, New York, N. Y., on the brief), *for plaintiffs-appellants.*

LAURENCE VOGEL, Asst. United States Attorney Southern District of New York (Robert M. Morgenthau, United States Attorney, So. District of New York, and Joseph Krovner, Dept. of Justice, on the brief), *for defendant-appellee.*

SMITH, *Circuit Judge:*

Ben D. Spivak and David S. Shapiro appeal from a May 16, 1966 judgment of the United States District Court for the Southern District of New York, Richard H. Levet, *Judge,* which dismissed their complaint for a refund of taxes and awarded the United States $27,192.27 with interest and costs on its counterclaim for 100% penalties pursuant to §§ 6672[1] and 6671(b)[2] of the Internal Revenue Code of 1954. 254 F. Supp. 517. We find no error and affirm the judgment.

The penalty assessments were for unpaid income withholding and social security (FICA) taxes for the first quar-

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[1] § 6672. Failure to collect and pay over tax, or attempt to evade or defeat tax.

Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable.

[2] § 6671(b). Person defined.—The term "person," as used in this subchapter, includes an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs.

ters of 1955 and 1956 due from Lincoln Industries, Inc., a corporation of which the appellants were the responsible officers.

The district court dismissed appellants' complaint because of failure to prove that their $50.00 and $60.00 payments were the amounts due the United States for one employee for each of the quarters involved as required. See *Steele* v. *United States,* 280 F. 2d 89 (8th Cir. 1960). The court went on to assert jurisdiction over the government's counterclaim and determined fully all the issues.[3]

In June 1965, Shapiro and Spivak became president and treasurer, respectively, of Lincoln Industries, a Virginia corporation engaged in the manufacture of furniture. Prior to this date, a bona fide dispute existed between Lincoln and the Internal Revenue Service about payments made by the Reconstruction Finance Corporation to IRS. Lincoln claimed that these payments should be credited to its tax liabilities and not, as was being done, to the tax debts of its parent, the Virginia-Lincoln Corporation. Judge Levet found that, had the disputed payments been credited to Lincoln, they would have covered the liabilities in question.

On July 16, 1956, Lincoln was adjudicated a bankrupt and in the ensuing proceedings the government filed a claim for unpaid taxes of $107,135.02 which the bankruptcy court reduced to $84,540.89. This sum included the taxes presently in issue. On February 22, 1960, the government compromised this claim for $42,971.26, even though the trustee had funds sufficient to pay it in full. Among other matters the settlement provided:

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[3] Since the decision on the appeal from judgment on the counterclaim is necessarily determinative of the claim for refund, it is unnecessary to pass upon the correctness of the dismissal of the complaint.

> In consideration of the payments above specified, the United States of America is to assert no further claim for Withholding taxes, FICA taxes, or FUTA [federal unemployment] taxes, penalties, or interest against the bankrupt or its Trustee herein.
>
> The offer [accepted by the government] is to be without prejudice to the United States in the assessment and collection of any outstanding assessments for penalties against former officers of said Lincoln Industries, Incorporated, on account of said Withholding and FICA taxes. 254 F. Supp. at 520.

Notice of the hearing on approval by the bankruptcy court of the settlement was given appellants, but they did not appear or otherwise object.

The court found that the appellants had a duty to collect and pay the taxes involved, were authorized to do so and were aware that payment had not been made. It found that the dispute about prior misallocation with the IRS was not the reason for non-payment. During the relevant quarters, appellants paid for raw materials and labor and thereby "voluntarily, consciously, and intentionally preferred other creditors of the corporation over the United States." 254 F. Supp. at 521. These facts are sufficient evidence of wilfulness. See *Bloom* v. *United States,* 272 F. 2d 215 (9th Cir. 1959), cert. denied 362 U. S. 803 (1960); *Horwitz* v. *United States,* 236 F. Supp. 812 (S. D. N. Y. 1964), aff'd 339 F. 2d 877 (2d Cir. 1965).

The primary issue for review is whether the compromise by the government in the bankruptcy proceeding of its claim against the corporation precludes it, in spite of the express reservation, from seeking the unpaid balance of the taxes from appellants. The question has been put in terms of whether the appellants are secondarily liable as

sureties for the taxes and are therefore arguably released by the form of the compromise with their obligor, or whether Lincoln and appellants are co-debtors with no suretyship relation between them. However, we are here concerned only with the collectibility of the penalty assessments, and with the nature of the obligation of the appellants to the United States.

The assessments, although collectible in the same manner as other taxes, is expressed as a "penalty" against the responsible person for failure to carry out the duties imposed on him by the act. The money has been collected from the employees, and not paid over to the trust funds. Those responsible are made directly liable for the payment. As *Bloom* v. *United States,* 272 F. 2d 215, (9th Cir. 1959) points out, the action is not one against a transferee of assets of the corporation, or one of a derivative character. The responsible person may not delay collection from him in order to protect any claim of his for reimbursement. *Kelly* v. *Lethert,* 362 F. 2d 629, 635 (8th Cir. 1966). So far as the United States is concerned, it is quite plain from the terms of the statute that the Congress intended that funds collected for these taxes be treated as a trust fund and that persons responsible for their paying over should be individually liable, as well as the corporation, for their diversion.

Appellants contend, however, that the United States should be barred from recovery on principles of estoppel. We do not agree. Any possible contention that the United States is estopped to assert its rights against appellants because of the compromise with Lincoln must fail in view of the reservation in the compromise agreement, and the appellants' knowledge of and acquiescence in its terms. The essential element of a misleading of appellants to their harm is strikingly absent. Compare *Freedman* v. *The Con-*

cordia Star, 250 F. 2d 867 (2d Cir. 1958), *Helvering* v. *Schine Chain Theatres*, 121 F. 2d 948 (2d Cir. 1941), *News Projection Corp.* v. *Western Union Tel. Co.*, 38 F. Supp. 854, 856 (S. D. N. Y. 1941).

Had the government's claim in the bankruptcy been defeated by an adjudication that the payments should have been credited to Lincoln, the government concedes that it would be bound to release appellants, for it is its practice not to attempt enforcement of § 6672 liability if the corporate obligation is met, and an adjudication that the payments should have been credited to Lincoln would have entitled Lincoln to credits as great as its entire tax obligation. The difficulty with appellants' position, however, is that there was no such adjudication, but only a partial payment of the corporate obligation in settlement of the disputed claim against the bankrupt estate, a settlement with full reservation of rights against them, to which, after notice, they did not object.

While in *Singer* v. *District Director*, 354 F. 2d 992 (1966), we limited our consideration to its facts (the United States had additional claims exceeding the bankrupt's assets), we think that decision may be extended to the situation here, that the Congress in enacting § 6672 was solely interested in protection of the revenue and intended that the trust funds be fully collectible from those responsible persons who caused the diversion as well as from the corporation for whose purposes they may have been used, without any duty to protect the delinquent, see *Kelly* v. *Lethert, supra*, and that compromise of the claim against the bankrupt estate of the corporation cannot serve to release the responsible persons from their direct liability under the statute.

The judgment is affirmed.

Relevant Statutes

Internal Revenue Code of 1954, Title 26, U.S.C., § 6672:

"§ 6672. Failure to collect and pay over tax, or attempt to evade or defeat tax

"Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable."

Internal Revenue Code of 1954, Title 26, U.S.C., § 6671(b):

"§ 6671(b) Person defined.—The term 'person', as used in this subchapter, includes an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs."

Bankruptcy Act, Title 11, U.S.C., § 50:

"§ 50 Compromise.

"The receiver or trustee may, with the approval of the court, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interest of the estate."

Bankruptcy Act, Title 11, U.S.C., § 104(a):

"§ 104. Debts which have priority.

"(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) * * *; (4) taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof which are not released by a discharge in bankruptcy: * * *".